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November 17, 2000

BY HAND DELIVERY

The Honorable Vernon A. Williams
Secretary, Surface Transportation Board
Case Control Branch
1925 K Street, N.W.
Washington, DC 20423-0001

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Re: STB Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures

Dear Secretary Williams:

Enclosed for filing in the above-referenced docket are an original and twenty-five copies of the Comments of the Committee To Improve American Coal Transportation On Proposed Rules. Also enclosed is a 3.5-inch diskette, formatted for WordPerfect 5.x, containing the pleading.

Thank you for your assistance.

Very truly yours,

Eric Von Salzen
Attorney for the Committee To
Improve American Coal Transportation

MIT/mpr

Enclosures

cc: All Parties of Record To Be Served

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS OF
THE COMMITTEE TO IMPROVE
AMERICAN COAL TRANSPORTATION
ON PROPOSED RULES

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November 17, 2000

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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No. 1)

MAJOR RAIL CONSOLIDATION PROCEDURES

**COMMENTS OF
THE COMMITTEE TO IMPROVE
AMERICAN COAL TRANSPORTATION
ON PROPOSED RULES**

Pursuant to the Board's October 3, 2000 Notice of Proposed Rulemaking, these Comments on the Board's proposed revisions to its regulations governing mergers of Class I railroads ("Proposed Rules") are being submitted by the Committee To Improve American Coal Transportation ("IMPACT"). 1/

SUMMARY OF COMMENTS

If the Interstate Commerce Commission had adopted something like the Proposed Rules a decade ago, that might have given the ICC and the Board tools to meet the challenge of railroad merger proposals during the 1990's by preserving intramodal competition while enhancing efficiency and eliminating excess capacity.

1/ IMPACT is an ad hoc group of energy companies that operate coal-fired electricity generation assets. The members of IMPACT are listed, with information about each of them, in Appendix A.

But today, trying to preserve the inadequate existing level of intramodal competition is not enough: The Board needs to adopt rules that will enhance competition, and restore competition that was lost in the mergers of the last decade. The Proposed Rules will not do this.

The Board should make clear that there is inadequate intramodal competition in the Class I railroad industry today, and it will not suffice, to obtain merger approval, for applicants to contend that their transaction will make matters no worse. For a merger to be approved it must <u>enhance</u> intramodal competition by <u>increasing</u> the number of independent rail carriers serving major markets, without decreasing the number of carriers serving any other significant, rail-dependent markets.

IMPACT's Comments focus on <u>intramodal</u> competition. It may be, as railroads have often argued before the Board and its predecessor, that for some lines of business railroads face <u>intermodal</u> competition – principally from trucks, occasionally from water carriers – that prevent railroads from exploiting market power; IMPACT takes no position on that contention. But for customers that require large volumes of coal transported several hundred miles, there is no viable alternative to rail transportation. If we do not have adequate intramodal competition, we do not have competition at all.

In these Comments, IMPACT explains, <u>first</u>, that the current level of intramodal competition in the railroad industry is inadequate, and that at least three rail carriers are needed in major markets to provide adequate competition.

Second, IMPACT recommends specific revisions to the Proposed Rules that will promote and restore intramodal competition.

Third, IMPACT discusses several other ways in which the Board's Proposed Rules may be made more effective. 2/

A. THREE RAILROADS ARE REQUIRED TO PROVIDE ADEQUATE INTRAMODAL COMPETITION IN THE RAILROAD INDUSTRY

The Proposed Rules state the following as an objective of the Board's merger policies:

> [B]efore we approve any major transaction – which in turn may, and likely will, result in responsive merger proposals by other Class I carriers – we must be confident that at the end of the day a balanced and sustainable rail transportation system is in place.

Ex Parte No. 582 (Sub-No. 1) (Decision served Oct. 3, 2000) ("Notice of Proposed Rulemaking"), at 11. But today, as a result of mergers approved by the Board and the ICC, the U.S. railroad industry already has too few Class I railroads to provide "a balanced and sustainable rail transportation system". There is no way that mergers which reduce the number of Class I carriers in major markets can possibly improve that situation.

2/ With IMPACT's May 16, 2000 Comments on the Advance Notice of Rulemaking we submitted Statements by two experts in transportation economics: Michael A. Nelson and William B. Tye. Their analyses are equally relevant to the present Comments on the Proposed Rules, and we will refer to them from time to time in the present Comments.

The Class I railroad industry today is extremely concentrated. Few railroad-dependent shippers and receivers are served by more than two independent Class I railroads, and many customers are served by only one. As IMPACT said in its May 16, 2000 Comments (at 9), "It would not be enough for the Board to adopt merger policies that merely arrest the slide to duopoly and preserve the status quo." What the Board needs is a policy that will <u>increase</u> the number of Class I railroads serving major rail-oriented markets.

Experience has demonstrated that intramodal competition in the railroad industry is much more effective where customers have at least three rail options than where there are only two carriers.

The analyses in the statements of Dr. Tye and Mr. Nelson attached to IMPACT's May 16, 2000 Comments demonstrated the importance of having three railroads in a market, and the adverse consequences that rail-dependent customers – like the members of IMPACT – have suffered as a result of the approval of "3-to-2" mergers during the 1990's. Dr. Tye cited the DOJ/FTC merger guidelines and several empirical economic studies to show how important a third competitor is to ensuring the vigor of competition. Mr. Nelson presented evidence that the reduction in the number of major western rail carriers from three to two as a result of the UP/SP merger caused injuries that the Board's theory predicted would not occur.

The recognition that three competitors are better than two is not new. Until the UP/SP merger, the Board's predecessor followed a pragmatic, common-sense approach, in which it observed that there may be less to be concerned about when a merger caused a 3-to-2 reduction in intramodal competition than when the reduction was 2-to-1, but it did not regard a 2-to-1 situation as necessarily benign. In its decision on the SF/SP merger, the ICC said that "the mere reduction rather than elimination of competitors, e.g., from three to two, may create serious anticompetitive problems . . . ." Santa Fe Southern Pacific Corp. – Control – Southern Pacific Transportation Co., 2 I.C.C. 2d 709, 792 (1986) ("SF/SP"). In Burlington Northern Inc. – Control and Merger – Santa Fe Pacific Corp., ICC Finance Docket No. 32549 (served Aug. 23, 1995) ("BN/SF"), the ICC explained:

> We examine several criteria in assessing whether markets served by the merging parties will suffer competitive harm. * * * Where most or all of the firms in the market have sufficient capacity to serve a significant amount of total market sales, and there is no significant disadvantage in obtaining these sales, the analysis considers the number of competitors rather than their market shares. The determination of competitive harm is ***more evident*** where the possible routing options on a rail-bound commodity drop from two originating or terminating railroads to one.

1995 WL 528184, *46 (emphasis added). 3/ Although competitive harm might not

3/ We are not citing BN/SF as an example of good rail merger policy. On the contrary, the ICC's failure in that case to consider the obvious "downstream" effects of the proposed merger led straight to the UP/SP merger and the current duopoly in the West. But with specific reference to the 3-to-2 issue, the ICC at least stated the right rule.

be as "evident" in a 3-to-2 market as in a 2-to-1 market, if harm were found to exist in a particular market, BN/SF held that this would be a proper subject for a remedy through imposition of appropriate conditions. Id. at *79. 4/

Even if, after the merger, two or more competitors continue to exist, the ICC felt that there might still be cause for concern about intramodal competition. See Union Pacific Corp. – Control – Chicago & North Western Transp. Co., ICC Finance Docket No. 32133 (served Mar. 7, 1995). In that case, prior to the control application, three railroads (BN, CNW, and the Soo Line Railroad ("Soo")) provided joint line service north of the Kansas City gateway and four railroads (UP, Santa Fe, SP, and the Kansas City Southern Railway ("KCS")) provided joint line service south from Kansas City. The ICC imposed conditions in response to Soo's concern that, because of the terms of certain Soo/CNW joint facility agreements, UP would have the power to block any attempt by Soo to interchange with any of the railroads running south of Kansas City to provide "seamless" transportation service in competition with UP/CNW in the Upper Midwest-South Central corridor. 1995 WL 141757, *22. The conditions were imposed notwithstanding the fact that Soo was not the only independent railroad operating at the north end of the corridor and

4/ In the UP/MKT case, the Board granted trackage rights over the merged systems' "North End" to prevent a 3-to-2 reduction in rail competition. Union Pacific Corp.—Control—Missouri-Kansas-Texas R.R., 4 I.C.C.2d 409, 452-53 (1988)("UP/MKT"). Such rights had earlier been awarded to MKT for the same reason in Union Pacific – Control – Missouri Pacific; Western Pacific, 366 I.C.C. 459, 567 (1982).

that its Kansas City line was not the only independent line over which traffic in that corridor could be transported. Id. at *81.

However, this pragmatic attitude changed in 1996 when the Board approved the UP/SP merger, and moved from saying that competitive harm is "more evident" in 2-to-1 markets than in 3-to-2 markets, to suggesting that markets that include two railroads are competitive enough. The Board rejected concerns that the merger of UP and SP, following the merger of BN and SF, "will create a rail transportation duopoly in the West, leading to tacit collusion and higher prices * * * ." 1996 WL 467636, *91. The Board observed that "Experience with rail mergers since 1980 indicates that carriers have not colluded in two-railroad markets." Id. 5/

The Board followed the same permissive approach when it approved the acquisition of Conrail by NS and CSX, which reduced the number of railroads in large portions of the Northeast from three to two. This recent view has led the rail industry to evolve into a duo of duopolies, one in the East and another in the West, and it is this reality that the Board's new merger rules must address.

5/ The Board devoted a detailed Appendix to a purported refutation of claims that the two railroads in the West following the UP/SP and BN/SF mergers would be likely to collude rather than compete. Appendix E: Duopoly Issues, 1996 WL 467636, *217-22.

The Board should seek to foster enhanced intramodal competition in the railroad industry and to increase the number of markets in which at least three railroads compete. Specific proposals toward that end are discussed below.

B. MERGER RULES SHOULD ENCOURAGE THE RESTORATION OF ADEQUATE INTRAMODAL COMPETITION

There are two disturbing aspects of the Proposed Rules: First, they fail to require that merger applicants provide means to enhance intramodal competition, and second, they seem to assume that Class I railroad mergers must continue to be approved, even to the point of duopoly.

Although the Proposed Rules and the Board's discussion of them refer repeatedly to the need to enhance competition, not merely preserve it, see, e.g., Notice of Rulemaking, at 12 (Proposed § 1180.1 (c)), 13, 14 (Proposed § 1180.1 (c) (1)), 16 (Proposed § 1180.1 (d)), 31 (Proposed § 1180.6 (b) (10) (ii))), they are silent on how this is to be done.

> Competition can be enhanced in many ways and we do not want to limit the approaches that could be proposed to enhance competition here. The focus of such a plan for enhancing competition could be placed on enhancing intramodal, or rail-to-rail, competition, for example, the granting of trackage rights, the establishment of shared or joint access areas, the removal of "paper" and "steel" barriers, and other techniques that would preserve and enhance railroad competition.

The Board is certainly wise not to attempt to prescribe some rigid formula for how to enhance competition, but the Board should make clear that intramodal competition must be enhanced; as Vice Chairman Burkes observed in his separate comments in the Notice of Proposed Rulemaking (at 40):

> . . . I question whether or not the [Board's] proposed changes adequately place the focus on the enhancement of intramodal, or rail-to-rail, competition because that is generally what is lost in railroad mergers. I hope the parties will comment on whether the proposed language provides the Board with needed flexibility or whether more specific language is required in our final rules.

Railroads seeking merger approval always contend that the proposed transaction will be pro-competitive because it will enhance their ability to compete with trucks. The Board should make clear that this will not suffice under its new rules, that a merger must include provisions to enhance intramodal competition, that is, must introduce new, independent rail carriers into major markets.

Unless the Proposed Rules make this clear, they cannot achieve the necessary objective.

In its discussion of the Proposed Rules, the Board recognizes that the railroad industry has changed during the Staggers Act era in ways that require a change in merger policy.

> While the existing policy statement focuses on greater economic efficiency and improved service as the most likely and significant public interest benefits, our proposed statement adds and highlights enhanced competition as an important public interest benefit, recognizing that, with only a few Class I carriers remaining, a transaction involving Class I rail carriers will affect the entire transportation system, including highways, waterways, ports, and airports.

Notice of Proposed Rulemaking, at 11. However, the Board appears to treat the continuation of rail mergers as inevitable. The Board refers in the passage quoted above to "a transaction involving Class I rail carriers" as though this was an acceptable event, and two sentences later to "any companies that result from an additional (perhaps final) round of consolidations" (Id.). After saying that merger applications must "include provisions for enhanced competition" (id. at 12), the Board fails even to threaten to deny an application if it does not include such provisions; the Board will approve the merger, but impose conditions "to preserve and enhance competition."

If language like this is adopted, the Class I railroads will draw the obvious conclusion that it is going to be pretty much business as usual as far as mergers are concerned in the future. Applicants may have to provide more window dressing in terms of "enhancing" competition, ideally competition with trucks, and they may have to make their statements of the alleged "public benefits" look more quantitative than they have in the last several mergers, but if they do this, the Board would be prepared to approve the "additional (perhaps final) round of consolidations" leading to a continent-wide duopoly. This is the wrong message.

The Board needs to make clear that, not only is further concentration in the railroad industry not acceptable, the current degree of concentration is not acceptable. A merger should not be approved unless it enhances intramodal competition, by increasing the number of independent rail carriers serving major markets, without decreasing the number of carriers serving any other significant, rail-dependent markets.

Let's consider what this means. Suppose that a merger is proposed between western railroad A, (either UP-SP or BNSF) and eastern railroad B (NS-CRC or CSX-CRC). The applicants would tout this as an "end-to-end" merger. Yet experience teaches us that even an entirely end-to-end merger would threaten at least some reduction in competition; as the Board says, "Competition in product and geographic markets can also be eliminated or reduced by end-to-end mergers." Notice of Proposed Rulemaking, at 14 (Proposed § 1180.1 (c) (2) (1)). In fact, parties to "end-to-end" mergers almost always serve some of the same origins and destinations, so such a merger would result in a reduction in direct intramodal competition, too.

Although the Board has historically imposed conditions to ameliorate the anticompetitive consequences of a merger, experience teaches that it is unlikely such conditions will actually preserve <u>all</u> pre-merger competition. But even if the conditions succeeded in preserving competition, the best that could be hoped for out of the transaction would be that the inadequate competitive situation is not made worse. In the current state of the Class I railroad industry, that should not be sufficient.

So, to gain approval of such a merger, the merging carriers should have to propose something new in addition to the usual conditions, a way to <u>increase</u> the number of independent carriers serving some significant markets. For example, western railroad A could agree to divest certain of its lines to railroad C, i.e., either the other eastern railroad or perhaps one of the Canadian railroads, and eastern railroad B could agree to divest certain of its lines to railroad D, either the other western railroad or one of the Canadian roads. As a result, the number of railroads serving some markets would be increased, while (if conditions are properly imposed) competition would not be decreased anywhere.

Such proposals should be initiated by the carriers involved, not by the Board, but the Board should carefully scrutinize each such proposal to be sure that it really would enhance intramodal competition as promised. If the applicants failed to convince the Board of this, the proposed merger should be denied. It should not be the Board's job to fashion a remedy to permit consummation of a merger if the applicants fail to do so.

If participants in an industry that is already too concentrated want to obtain the prospective profits of a merger (if the merger was not expected to be profitable, it would not be proposed), there is no reason why they should not be required to share a <u>portion</u> of that private benefit of the merger with the public by conditioning the merger in a way that will <u>enhance</u> rail competition.

In the past, the Board has said that competition-enhancing conditions should not be imposed because they would impair the benefits that the merging railroads would obtain from the merger. While the rail industry was financially weak, this made sense. But the industry is no longer weak, and it is now more concentrated than it has ever been before. It is time for a new approach.

Moreover, imposing conditions to enhance competition is not as radical a departure as the railroads would claim. Look, for example, at the recent Conrail acquisition. The Shared Assets Areas that were created in that case make it possible for two competing rail carriers to serve customers who previously faced a Conrail monopoly. Of course, this was not a merger condition imposed by the Board to enhance competition, but was developed by NS and CSX as a means to accomplish the difficult task of dividing up the Conrail system between them. Nevertheless, it shows that it is possible, in the context of a merger, to find ways to enhance intramodal competition. If the Board required that railroads seeking approval of a merger come up with ways to enhance competition, is there any reason to think that they would show less creativity than NS and CSX did in finding a solution to the problem of divvying up Conrail?

In the same case the Board imposed a condition, at the request of New York State and New York City, that allowed an independent rail carrier to establish limited service east of the Hudson River, in competition with CSX. 6/ The rationale for this condition was that it replaced competition that had been lost in the rail crisis that led to the creation of Conrail. The effect of the condition was to remedy a competitive problem that had been created in a previous transaction and to add

6/ CSX Corp. – Control and Operating Leases/Agreements – Conrail, Inc., STB Finance Docket No. 33388, slip op. at 177 (served July 23, 1998).

intramodal competition to a market that had not enjoyed it for more than a quarter century.

The Board should revise its Proposed Rules to make clear that future Class I rail mergers will not be approved unless they increase effective intramodal competition. In all of the references in the Proposed Rules to enhancing competition, the Board should make clear that this means enhancing intramodal competition by effectively introducing new carriers into significant rail markets. How many markets need be so addressed should depend on the size of the proposed transaction, and the benefits that the applicants would gain from it.

C. THE BOARD'S PROPOSED RULES CAN BE IMPROVED IN SEVERAL OTHER RESPECTS

IMPACT proposes that the Board make the following additional changes to its Proposed Rules.

1. Service Assurances.

Most recent major rail mergers have caused service disruptions, ranging from significant to "meltdown", notwithstanding the merger applicants' predictions of efficiencies and better service. In light of this experience, the Board has wisely proposed to require future merger applicants to provide "service assurance plans" as part of their applications. Proposed §§ 1180.1 (h), 1180.10. IMPACT supports this proposal.

However, experience teaches that any major rail merger is likely to be accompanied by significant service problems, despite the applicants' best planning efforts and most sincere assurances. Class I railroads are large, complex organizations, and they function as part of an even more complex network that includes other large railroads, shortlines and regional carriers, customers (which often supply equipment to carry their loads), other transportation modes, and so forth. As railroads grow larger and larger through mergers, while downsizing eliminates supposedly excess facilities and personnel, integration becomes more and more difficult. Apparently, even the managements of what were formerly regarded as well-run railroads failed to appreciate how complicated these enterprises are. 7/ Moreover, the extreme concentration in the railroad industry today means that, when a merged railroad's lines and yards are so clogged that cars cannot move, there too often is no other railroad that can provide substitute service. When implementation plans go awry, rail customers suffer – particularly rail-dependent customers. 8/

7/ The service breakdowns raise a serious question whether the big railroads may not already be "too big" in the economic sense -- that is, that difficulties in management and control may make them less efficient than they would be if they were smaller.

8/ In its May 16, 2000 Comments (at 14), IMPACT urged that merger applicants be required to provide back-up plans to allow independent carriers to provide service (including the right to operate over lines of the merged system, and the right to override paper barriers that restrict otherwise-accessible shortlines), when merger-related disruptions prevent a carrier from providing normal service. The Board's Proposed § 1180.10 (i) would apparently require this. To avoid any misunderstanding, however, IMPACT suggests that the Board state explicitly that its requirement that "contingency plans [must be] in place" means that alternative rail service can go into effect when needed, without requiring lengthy administrative proceedings, such as were required to address the UP/SP service meltdown.

Therefore, in addition to service assurance plans, the Board should require merger applicants to provide specific and enforceable assurances to their customers against service disruptions. These assurances should include damage recovery and financial penalties to compensate customers if the merger results in service disruptions. Customers would have the right to be heard in the merger proceedings if they are not satisfied by what the merger applicants have offered, and the Board would weigh these concerns in deciding whether or not to approve the proposed merger.

2. Downstream Effects; Cumulative Impacts and Crossover Effects; A "Cooling Off" Period Between Mergers.

For the reasons discussed in IMPACT's May 16, 2000 Comments, we support the Board's proposal to jettison the "one case at a time" approach embodied in its current merger regulations. Under Proposed § 1180.1 (i) the Board would "consider the cumulative impacts and crossover effects likely to occur as rival carriers react to the proposed combination." Merger applicants would be required to "anticipate with as much certainty as possible what additional Class I merger applications are likely to be filed in response to their own applications" and to address how such events would affect the structure of the industry, the calculation of public benefits, and the conditions to be imposed. If this rule had been in effect when the BNSF merger came before the ICC, that transaction could not have been approved without considering that UP's inevitable response would be to acquire SP, thus creating a duopoly in the West.

Although this change in the Board's merger rules is sorely needed, it may prove difficult to apply in practice. Predicting exactly how the end game of rail mergers is likely to play out may be controversial, and any estimate of the effects of various possible outcomes will be condemned by some interested parties as speculative.

This is one of the reasons that IMPACT has proposed an additional change to the Board's merger rules that would require a reasonable "cooling off" period between major rail mergers. Under IMPACT's proposal the Board would have the power to refuse to consider any merger application involving Class I railroads that is filed within 36 months after the implementation of a previous merger of Class I's. However, this cooling off period would not apply to merger proposals filed as "responsive" merger applications <u>in the proceedings on the initial merger</u>.

Thus, this proposal would enhance the Board's ability to address the downstream merger effects problem in two ways. <u>First</u>, if other railroads react to a proposed merger by filing their own responsive merger applications in the same proceeding, the Board would not have to speculate about what the downstream mergers might be; they would be filed in the same proceeding as the initial merger proposal. The parties could present evidence about the cumulative impacts of the several specific proposed transactions, and the Board could evaluate that evidence in one comprehensive proceeding. The responsive applications could provide the vehicle for market-driven initiatives to introduce (or restore) competition. If there is to be a merger "end game", the chances of bringing it to a conclusion that serves the public interest would be enhanced if all the moves of all the players could be considered in one proceeding.

Imagine, for example, what would have happened if the UP/SP merger had been filed as a responsive application in the BN/SF merger proceeding. The ICC would have been able to consider in one proceeding whether the western duopoly that would result from the two mergers was truly in the public interest. Instead, when the UP/SP merger came before the Board for approval, the BN/SF merger was a fait accompli, and the Board was faced with either acquiescing in the creation of a duopoly or leaving BNSF dominant in the West over the unmerged UP and SP.

Second, if non-applicant railroads elect not to file responsive merger applications, the Board would know that there would be a period of three years between the implementation of the pending merger and the filing of the next one. This lapse of time would reduce the crossover effects that the Board would have to consider in deciding the first merger. Moreover, after three years, when another merger application was filed, the Board would be in a better position to evaluate the second merger, because the competitive relationships created by the first merger would at least have begun to emerge. 9/

9/ A requirement for a pause in merger activity would also address merger-related service problems by providing a breathing spell for rail customers, as well as

[Footnote continued]

Of course, there may be circumstances in which a pause between mergers is not necessary. Therefore, IMPACT's proposed new regulations would allow merger applicants to seek a waiver from the Board that would allow them to file their application before the end of the 36-month period. However, unless the Board were convinced that a new merger could be effected without injury to the public, the pause would be required.

IMPACT urges the Board to revise its Proposed Rules to incorporate the "cooling off" period concept.

3. Remedies for Competitive Problems in Rail Mergers; Divestiture; Construction of New Rail Facilities; Bottleneck Relief.

The Proposed Rules promise to use the Board's conditioning power aggressively to combat the anticompetitive effects of Class I rail mergers. Proposed § 1180.1 (d). IMPACT supports this goal. 10/ However, we urge the Board to be more specific in its rules about how this is to be done.

a) Deny Anticompetitive Mergers. The practice of the Board and its predecessor has generally not been to disapprove a merger that it finds to be

[Footnote continued]

for the railroad industry itself, to adjust to the new service and competitive realities created by one merger before having to address the next merger proposal.

10/ In this discussion, we focus on the Board's use of conditions to ameliorate the anticompetitive effects of mergers. We reiterate, however, that the Class I railroad industry is so concentrated today that no merger, no matter how conditioned, should be approved without including mechanisms to increase the number of railroads serving major markets, as discussed in Part B of these Comments.

anticompetitive, but rather to approve it subject to "conditions" that are supposed to "cure" the competitive problems. 11/ This approach has fostered the increasing concentration of ownership in the railroad industry. IMPACT urges the Board to make clear that it will not use its conditioning power to save a flawed transaction: If applicants propose a merger without sufficient conditions to eliminate competitive injury, the Board should deny the merger. This will encourage applicants to be forthcoming in their applications, rather than hoping that the Board will overlook some of the competitive problems.

b) Do Not Tailor Conditions Too Narrowly. The conditions imposed by the Board and ICC have not redressed all the competitive injuries caused by rail mergers. The Board has insisted that conditions be imposed only to address specific, narrowly-defined competitive problem created by the proposed merger. The Board has also tended to scrutinize very strictly shippers' claims of competitive injury from proposed mergers, and to grant relief only when injury is most obvious; thus, more subtle competitive problems, and injuries to customers or industries that are not able to participate effectively in Board proceedings, tend to be overlooked.

As the rail industry has become more concentrated, it has fallen more and more to rail customer groups to propose merger remedies, whereas a decade ago this role was played by other railroads. Such groups quite naturally focus on the interests of their own particular industry or membership. Small or unorganized

11/ No Class I merger has been denied since the SF/SP in 1986.

customers or other interests may not have the resources or specialized knowledge needed to make or support a case before the Board in support of conditions. See the discussion in Mr. Nelson's Statement.

Because the Board has tended to impose the most narrowly tailored merger conditions possible to remedy whatever competitive problems are found to exist, it is almost inevitable that more competition has been lost than has been restored through conditions.

IMPACT recommends that the Board reverse its presumptions with respect to conditions. If a proposed rail merger will materially increase concentration in a market (e.g., if it would reduce the number of competing railroads in a market), then the burden of proof should rest on the merger applicants to establish that all competitive harm from the merger can be eliminated through appropriate conditions. Where there is doubt about how extensive conditions need to be to remedy threatened competitive harm, the Board should err on the side of greater protection of competition, rather than less. As discussed above, this would include a Board decision to deny the merger application where competitive considerations so warrant.

c) Divestiture Should Be The Preferred Remedy For Competitive Problems. In normal antitrust practice outside the railroad industry, if a merger will cause an unacceptable reduction in competition in certain markets, it is common for the antitrust agencies to require that the merging companies divest some of their assets in order to preserve competition in those markets. Board and

ICC practice, however, has not favored divestiture, but instead has relied on lesser remedies, especially granting a supposedly-independent railroad the right to move traffic over certain lines of the merged railroad (for example, through trackage rights or haulage rights) in order to restore lost competition.

Trackage or haulage rights, however, have many shortcomings, and may not effectively replace the competition that is lost as a result of the merger. As Mr. Nelson pointed out in his May 16, 2000 Statement, trackage rights compensation is often set in a way that precludes replication of the competition that existed prior to the merger. Furthermore, such trackage rights are often limited in scope, for example as to types of traffic that can be handled, or points that can be served. As a result, the grantee of the trackage rights is necessarily a less effective competitor than was the railroad that owned the line before it was merged with its competitor.

In imposing conditions on a merger of competitors, the Board's objective should be to replace all the competition that the merger takes away. If the lost competition was provided by a railroad that owned its own lines, then in most cases that competition can best be replaced by an independent railroad that owns those lines.

IMPACT therefore recommends that the Board make greater use of <u>divestiture</u> of rail lines to an independent railroad as a remedy for anticompetitive merger effects, with trackage or haulage rights over the rail lines granted to the merged carrier if appropriate.

Whenever trackage or haulage rights are granted in connection with a merger, whether to the merged carrier over lines divested to an independent railroad, or to an independent railroad over lines of the merged carrier, they should be structured to ensure that the recipient of the rights is able to compete effectively with the line owner, to preserve the full scope of competitive influences that would otherwise be lost in the merger. This means that full service rights are to be preferred to overhead or other limited rights, and compensation should be set at a level that will encourage effective competition.

d) Rail Line Construction Should Be Facilitated. Because the objective of Board policy should be to encourage enhanced intramodal competition, not merely to preserve existing, inadequate levels of competition, the Board should encourage the construction of new rail lines. A new line, such as a "build out" or "build in", may make it possible for a rail-dependent customer that is "captive" to one railroad to obtain service from a competing railroad. The Board has recently applied its existing merger rules to preserve potential build-in and build-out opportunities under conditions applicable to "2-to-1" points. 12/ For the reasons discussed in Part A, above, IMPACT urges the Board to expand this build-in/build-

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12/ For example, earlier this year, in Decision No. 88 in the UP/SP merger proceeding, the Board held that the "2-to-1" conditions imposed on that merger preserved Entergy's option to obtain competitive rail service by constructing a build-out at its White Bluff plant. Union Pacific Corp. – Control and Merger – Southern Pacific Rail Corp., STB Finance Docket No. 32760 ("UP/SP") (served Mar. 21, 2000).

out remedy to "3-to-2" situations as well. More generally, IMPACT urges the Board to facilitate all new construction proposals that respond to Class I rail mergers.

Moreover, going beyond the question of merger conditions, we also urge the Board to grant a general class exemption for the construction of new rail lines to encourage this pro-competitive activity. Under existing law, there is no specific exemption applicable to a proposal to construct a new rail line, as there is, for example, for a proposed grant of trackage rights. A railroad, shipper, or other party that wants to construct a new rail line must either submit to the Board an application for approval, or must petition the Board to exempt the particular transaction from Board approval.

Although having to file a request for exemption does not impose an insuperable burden, the absence of a specific exemption for new line construction implies (rightly or wrongly) a negative attitude by the Board toward such construction. Moreover, the current procedures provide an opportunity for a railroad that opposes new competition to delay that competition and further entrench its dominance of the market. 13/ Because of the uncertainty as to how the Board would treat an exemption request, most major line construction proposals in the past have been submitted through a formal application.

13/ In the recent Entergy build-out case, Entergy filed a petition for exemption to build an 8.6 mile line on July 30, 1999. Opposition by the incumbent monopolist, UP, delayed the conditional grant of exemption until May 4, 2000. Entergy Arkansas – Construction and Operation Exemption – White Bluff to Pine Bluff, AR, STB Finance Docket No. 33782 (served May 4, 2000).

To encourage the construction of new rail lines, which can improve service and enhance competition, the Board should amend its rules to exempt all new rail construction projects (opponents of an exempt line construction transaction would be permitted to file a petition to revoke, but the petition would not stay the effectiveness of the exemption). In addition, environmental review, which is typically required for major line construction proposals under current regulations, should be expedited.

e) <u>The Board Should Abandon the "One Lump" Theory</u>. Receivers of rail shipments of coal have a particular interest in the abandonment of the Board's unquestioning reliance on the "one lump" theory. This theory holds that if one railroad has a monopoly over any <u>portion</u> of a route, it can extract its full "monopoly profit" for the entire movement, so the customer will be no worse off if a merger increases the railroad's monopoly to cover more or all of the route. The Board has frequently used this theory as a rationale for denying competitive relief to utilities in merger cases.

The "one lump" theory fails to take account of important competitive realities, as Dr. Tye demonstrated in his Statement. IMPACT urges the Board to abandon its reliance on this theory as an irrefutable economic principle and consider, instead, the ways in which vertical integration may produce competitive harm for shippers in the specific circumstances of each merger. Merger proponents who advocate the applicability of the "one lump" theory should be required to prove its relevance and application in fact. Mergers should not be approved that would impair the ability of shippers to challenge the reasonableness of "bottleneck" rates.

CONCLUSION

IMPACT urges the Board to modify the Proposed Rules to require that Class I merger applications be granted only if they would increase the number of railroads serving major markets, while not reducing competition elsewhere. IMPACT further urges the Board to incorporate into its Proposed Rules the other recommendation discussed above. As so modified, the new merger rules would make an important contribution to the goal of achieving "a balanced and sustainable rail transportation system" that will "compete effectively and deliver necessary services, now and into the future."

Respectfully submitted,

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November 17, 2000

APPENDIX A

Members of IMPACT

Arkansas Electric Cooperative Corporation

Arkansas Electric Cooperative Corporation, a generation and transmission cooperative with 1,916 megawatts of generation capacity, is the power supplier for 16 of Arkansas' electric cooperatives, which serve approximately 400,000 homes, farms, businesses, and industries located in each of the 75 counties in Arkansas. In partnership with investor-owned companies and municipal systems AECC has constructed three low-sulphur coal-fired generation plants, at White Bluff, Independence, and Flint Creek. AECC's share of these plants totals 1,408 megawatts.

AECC's ownership share of the three coal-fired plants uses about 5 million tons of Powder River Basin coal annually. This coal is transported to the plants by rail, a distance of up to 1,400 miles. AECC provides about 1,000 rotary dump cars for the movement of this coal.

Edison Mission Energy and Midwest Generation LLC

Edison Mission Energy is one of the largest and most successful global power producers, with projects in Australia, Indonesia, Italy, New Zealand, the Philippines, Spain, Thailand, Turkey, and the United Kingdom, as well as the United States.

Midwest Generation acquired the fossil-fuel-fired generating assets of Commonwealth Edison Company in 1999 and owns seven generating stations and four combustion turbine sites in northern Illinois. These facilities have a total generating capacity of 9,510 megawatts of electricity, and under a Power Purchase Agreement with Commonwealth Edison Company they serve approximately 3,500,000 customers. Midwest Generation also supplies electricity into the regional grid and thence into service areas as far away as the East Coast. Midwest Generation employs nearly 1,800 people in Illinois and Pennsylvania.

Midwest Generation burns coal in many of its generating stations and is heavily dependent on reliable rail transportation to move this coal from the point of production to the point of use. Six of its seven Illinois generating stations use coal that is delivered by rail 1,100 miles from the Wyoming Powder River Basin (PRB). Midwest Generation receives some 15 million tons of PRB coal each year, most originated by Union Pacific and the remainder by Burlington Northern Santa Fe. To carry this coal, Midwest Generation leases an active fleet of 4,031 rail cars.

UtiliCorp United

Based in Kansas City, MO, UtiliCorp United is an international energy and services company with about 4 million customers. It operates in the United States, Canada, the United Kingdom, Spain, Germany, Norway, New Zealand, and Australia. At March 31, 2000, UtiliCorp had $7.5 billion is assets and 12-month sales of $19.6 billion.

UtiliCorp has a strong national presence as a provider of competitive and innovative energy solutions. For 1999, it was ranked the second-largest wholesale marketer of electricity in the U.S., and the third-largest marketer of natural gas. UtiliCorp serves electric and gas utility customers in Missouri, Kansas, Iowa, Nebraska, Colorado, Michigan, and Minnesota. It markets natural gas and electricity to industrial and wholesale customers in nearly all the contiguous 48 states.

CERTIFICATE OF SERVICE

I hereby certify that on November 17, 2000 I caused to be served, by first-class mail prepaid, a true and correct copy of the foregoing Comments of the Committee To Improve American Coal Transportation on Proposed Rules on all Parties of Record in STB Ex Parte No. 582 (Sub-No. 1).

Marta I. Tanenhaus

Marta I. Tanenhaus

Dated: November 17, 2000

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